COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF THE UNION LIGHT, HEAT, AND POWER COMPANY FOR AN ADJUSTMENT OF RATES	)	CASE NO. 92-346

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O R D E R

The Union Light, Heat and Power Company ("ULH&P") operates as a public utility providing electric and gas service in Boone, Campbell, Gallatin, Grant, Kenton, and Pendleton counties. Within those counties, ULH&P furnishes gas service to approximately 67,754 customers. On September 16, 1992, ULH&P applied to this Commission for authority to adjust its rates for gas service on and after October 16, 1992.

The rates proposed by ULH&P would produce additional annual revenues of $8.5 million, representing an increase of approximately 13.1 percent. ULH&P failed to meet the minimum filing requirements of 807 KAR 5:001, Section 10, was notified, and cured those deficiencies September 25, 1992. Pursuant to KRS 278.190, ULH&P's proposed rates and charges were suspended up to and including March 24, 1993.

Motions to intervene were filed by the Citizens Organized to End Poverty in the Commonwealth ("CO-EPIC"), Newport Steel Corporation ("Newport Steel"), and the Attorney General by and through his Utility and Rate Intervention Division ("AG"). All were granted. A public hearing was scheduled for January 25, 1993, but cancelled because ULH&P failed to publish notice of the hearing. On February 8, 1993, ULH&P and the Intervenors entered into a Joint Stipulation and Recommendation ("Settlement") which purported to resolve all issues in this proceeding. The Settlement allowed ULH&P additional annual revenues of $4.875 million effective April 1, 1993. On February 22, 1993, the Commission held a hearing to consider the reasonableness of the Settlement. By Order entered March 24, 1993, the Commission rejected the Settlement as resulting in unreasonable rates. The Commission then reset ULH&P's rate application for a full evidentiary hearing which was held April 19, 1993.

TEST PERIOD

ULH&P proposed and the Commission has accepted the 12-month period ending June 30, 1992 as the test period for determining the reasonableness of the proposed rates. In using the historic test period, the Commission has given full consideration to appropriate known and measurable changes.

NET ORIGINAL COST RATE BASE

ULH&P proposed a jurisdictional net original cost rate base of $85,772,265.[1] The Commission has made the following modifications to the proposed rate base:

Removal of Facilities Not Devoted to Kentucky Customers

In determining its jurisdictional net original cost rate base, ULH&P proposed to remove amounts from utility plant, accumulated depreciation, and propane inventory related to its propane cavern, processing facilities, and associated plant which were either partially or wholly used for the benefit of its parent company, The Cincinnati Gas and Electric Company ("CG&E"). Under the terms of

[1] Schedule B-1 of the Application.

an agreement between CG&E and ULH&P, 64 percent[2] of the propane facilities and inventory are dedicated to CG&E. ULH&P stated that this adjustment was consistent with its prior general rate cases. The AG opposed this adjustment, correctly noting that ULH&P did not propose this adjustment in its previous gas rate case, and indicated that ULH&P had possibly earned an excess return on this non-jurisdictional activity.[3]

That ratepayers should not be required to provide a utility a return on investments which do not serve them is a basic regulatory principle. However, ULH&P has properly allocated those facilities which are related to non-jurisdictional operations and the Commission accepts its proposal. In determining the jurisdictional net original cost rate base, the Commission has removed $5,143,461[4] from utility plant, $3,302,635[5] from accumulated depreciation, and $1,590,617[6] from the propane inventory, and has accepted the related adjustments proposed by ULH&P to investment tax credits and deferred income taxes.

Accumulated Depreciation

In computing its jurisdictional net original cost rate base, ULH&P used the test-year actual accumulated depreciation less accumulated depreciation related to facilities not devoted to

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2 Lonneman Direct Testimony, at 12.

3 DeWard Direct Testimony, at 17-18.

4 Application Workpapers WPB-2.2h and WPB-2.2i.

5 Application Workpaper WPB-3.1g.

6 Application Workpaper WPB-5.1b; difference between 13-month average balances shown for Account No. 151-76 and the allocated balance.

Kentucky customers. However, it did not adjust the test-year-end balance by the amount proposed for its depreciation expense adjustment. ULH&P cited five reasons for not doing so[7] and the AG argued that the adjustment should be made. The AG correctly noted that the Commission routinely adjusts accumulated depreciation by the amount of the depreciation adjustment, and that without this rate base adjustment there would be a mismatch between operating income and rate base.[8]

ULH&P has not offered any authority to support a departure from our long standing practice. Therefore, we will include the adjustment to test-year depreciation expense (explained elsewhere in this Order), in the accumulated depreciation used to determine rate base. The adjustment increases accumulated depreciation by $522,788.

Prepayments

ULH&P proposed to include $39,966 for the PSC Assessment and $5,424 for auto license taxes as a part of the prepayments component of rate base.[9] It argues that these expenditures must be paid in advance prior to being charged to operations, and are prepaid according to regulations.[10]

In previous ULH&P cases, the Commission has not included these in prepayments included in rate base. However, the auto license taxes should be included. The licenses have a useful life of one

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7 Lonneman Direct Testimony, at 20-21.

8 DeWard Direct Testimony, at 7.

9 Schedule B-5.1 of the Application. The PSC Assessment is referred to by ULH&P as "KYPSC Maintenance Tax."

10 Bruegge Direct Testimony, at 7-8.

year and the proper accounting would be to treat this expenditure as a prepayment. Therefore, the Commission has also included them as prepayments in the rate base.

The Commission is not persuaded to include the PSC Assessment as a prepayment in rate base. Including it would allow ULH&P to recognize the expense over the entire year, rather than in the month of payment. The Commission is not opposed to the concept of spreading this expenditure over a 12-month period. However, in determining whether this unamortized expense should be included in rate base, we must consider whether the funds were provided by ratepayers prior to or after the prepayment is recorded on the books. The assessment is based on the gross operating revenues of the utility for the prior calendar year, and it is notified of its assessments by July 1 of the following year. Thus, the assessment applies to sales which occurred prior to the recording of the prepayment.

The Commission includes the PSC Assessment in operating expenses in determining revenue requirements which provides full recovery of this cost. It is inappropriate to also include a return on the unamortized balance in the prepaid accrual merely because this cost is recovered annually and may be treated for accounting purposes as either an accrual or a prepaid expense.

Cash Working Capital Allowance

ULH&P determined its cash working capital allowance using the 1/8 formula methodology.[11] This methodology has been used in its past rate cases and continues to produce a just and reasonable

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11 Schedule B-5.1 of the Application.

result. We have adjusted the allowance for cash working capital to reflect the accepted pro forma adjustments to operation and maintenance expenses.

Unamortized Balances for Early Retirement, Prior Rate Case, and Management Audit Expenses

In determining rate base, ULH&P included the unamortized balance of its early retirement and involuntary separation costs ("downsizing costs"), and the unamortized balance of the rate case and management audit expenses,[12] both authorized in Case No. 90-041.[13] ULH&P seeks to recover its costs directly related to the annual reductions and savings in labor costs to be experienced in future years as reflected in the test-year adjustment.[14] ULH&P states that excluding a financial charge for the unrecovered deferred expenses from rate base denies it the proper recovery of carrying charges associated with these expenses.[15]

The AG opposed inclusion of all three items. He opposed the downsizing adjustment asserting that ULH&P had excessive employees prior to the downsizing.[16] Therefore, it would be inappropriate to include the unamortized balance of downsizing expenses in rate base. The AG argues that ULH&P should not recover prior rate case expenses in rate base because doing so would allow ULH&P to recover

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12 Schedule B-6 of the Application.

13 Case No. 90-041, An Adjustment of Gas and Electric Rates of The Union Light, Heat and Power Company, Order dated October 2, 1990.

14 Lonneman Direct Testimony, at 6-7.

15 Response to the Commission's Order dated October 21, 1992, Item 4(b).

16 DeWard Direct Testimony, at 15-16.

the expense of filing a case and a return on funds not yet recovered through rates.[17] The AG argues that the management audit expense should be excluded because the Commission has traditionally done so.[18]

These three items should not be included in ULH&P's rate base. However, we do not fully accept the AG's reasoning. There is no evidence in the record establishing that ULH&P retained excessive employees during the test year. As discussed later in this Order, we are recognizing an adjustment to ULH&P's recent downsizing expenses, but are not including the unamortized balance of the downsizing costs in rate base. To allow amortization of the costs and a return on the unamortized portion would inappropriately shift the expense of downsizing solely to the ratepayers. As both the ratepayers and shareholders should enjoy future benefits from downsizing, they should share its concomitant expenses. This can be accomplished by excluding any return on the unamortized portion of the downsizing costs.

ULH&P was authorized to begin recovering rate case and management audit expenses in rates on October 2, 1990 but did not request rate base treatment of these costs at that time. When this Order is effective, ULH&P will have recovered approximately 94 percent of the amount it seeks to include in rate base. It is inappropriate for ratepayers to pay a return on the unamortized portion of these expenses after ULH&P has recovered a majority of them through rates. The unamortized balances for downsizing, prior

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[17] Id., at 8.

[18] Id., at 9.

rate case, and management audit expenses will not be included in ULH&P's rate base.

Deferred Income Taxes

ULH&P deducted $8,665,363 in deferred income taxes in calculating its rate base. The AG proposed deducting additional deferred tax charges of $291,760 relating to post retirement benefits[19] because ULH&P has not included the accrual for post retirement benefits as an offset to rate base. He argues that it is inappropriate to increase rate base by the amount of the deferral when the book accrual for post retirement benefits is not deductible for tax purposes.[20]

We have been down this road before.[21] ULH&P's ratepayers benefitted from deferred income tax debits because, at the time they were recorded, book income tax expense was lower than the actual income tax liability. Ratepayers benefit from deferred income tax credits as the tax timing differences which produced the credits reverse. No new evidence has been produced which convinces us to reverse ourselves here. The jurisdictional balances for the deferred income taxes will be deducted in determining rate base.

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19 Id.

20 Id.

21 Case No. 90-041, Order dated October 2, 1990, at 12 and Case No. 91-370, Application of The Union Light, Heat and Power Company to Adjust Electric Rates, Order dated May 5, 1992, at 8.

Adjustments for "Cost-Free" Funds

The AG proposed to reduce ULH&P's rate base an additional $3,155,250[22] for unrecovered purchased gas costs, accrued property taxes, and accrued employee benefits. He argues that these amounts represent "cost-free" funds because ULH&P is able to recover the expense before payment of the liability. The AG further argues that the accrued property tax reduction to rate base is consistent with ULH&P's inclusion of prepayments in the rate base.[23]

ULH&P responds that proper accounting requires recognition of a liability for expenses owed but not paid. ULH&P also noted that there is a monthly matching between gas cost and gas cost recovery, and that the resulting short-term differences result from the operation of the recovery mechanism.[24]

The accrued liabilities listed by the AG would normally be considered if a lead lag study were performed to determine the appropriate amount for the cash working capital allowance. The AG has looked at only three accounts, and numerous other accounts would have to be considered in order to perform a proper analysis. It is not appropriate to randomly reduce ULH&P's rate base for these three items without analyzing all accounts in a lead lag study.

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22 DeWard Direct Testimony, at 9-12. Total is composed of $2,385,884 for unrecovered purchased gas costs, $274,463 for accrued property taxes, and $494,903 for accrued employee benefits.

23 Id., at 10-11.

24 Lonneman Rebuttal Testimony, at 1-2.

Based upon the previous findings, the Commission has determined the jurisdictional net original cost rate base for ULH&P's gas operations at June 30, 1992 to be as follows:

Total Utility Plant		$120,972,384
Add:		
Materials and Supplies -		
Gas Enricher Liquids	894,722	
Other	157,530	
Total Materials and Supplies	1,052,252	
Prepayments	312,291	
Gas Stored Underground	1,581,757	
Cash Working Capital Allowance	1,937,848	
Subtotal		+ 4,884,148
Deduct:		
Reserve for Accumulated Depreciation	31,250,493	
Accumulated Deferred Income Taxes	8,665,363	
Investment Tax Credits	134,107	
Customer Advances for Construction	1,783,360	
Subtotal		- 41,833,323
Total Jurisdictional Gas Net Original Cost Rate Base		$ 84,023,209

CAPITAL

ULH&P proposed a total company capitalization of $184,479,160[25] adjusted to reflect $20 million First Mortgage Bonds issued in August 1992 and $15 million of Common Stock issued in December 1992, and excluding First Mortgage Bonds reclassified to current maturity on July 1, 1992.[26] ULH&P included no short-term debt, stating that the proceeds from the sale of First

[25] Mosley Direct Testimony, Exhibit JRM, page 1 of 26.

[26] Id.

Mortgage Bonds and Common Stock would be used to repay all short-term debt.[27]

The AG proposed a total company capitalization of $183,240,333.[28] There were three differences between the AG and ULH&P proposals. First, the AG included the test-year-end outstanding balance for short-term debt minus the net proceeds from the $20 million sale of First Mortgage Bonds. Second, the AG excluded the sale of $15 million of Common Stock. Finally, the AG did not include the unamortized premiums and discounts on long-term debt.

The Commission has determined that, at test-year end, ULH&P's total company capitalization, before the inclusion of Job Development Investment Tax Credits ("JDIC"), was $182,337,414.[29] In ULH&P's past cases, the Commission has generally allocated the total company capital between electric and gas operations to determine the appropriate capital valuation for each. This method is appropriate for rate-making purposes and we have determined ULH&P's capital devoted to gas operations to be 43.968 percent of total capitalization based on the ratio of gas operations rate base to total company rate base as determined in Appendix B. The resulting capital assigned to gas operations is $80,170,446.[30]

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27 Mosley Direct Testimony, at 8.

28 Weaver Direct Testimony, Exhibit CGK Weaver, Statement 22.

29 Application Workpapers WPB-8.1, pages 47 through 49 of 54, June Balances for Account Nos. 201, 207, 216, 221, 225, 226, and 231.

30 Test-year-end total capitalization multiplied by the ratio of gas operations rate base to total rate base. The ratio is stated to three decimal places, but the actual computer calculation carried all decimal places.

As discussed earlier, ULH&P proposed to remove certain utility facilities not devoted to Kentucky customers from its jurisdictional net original cost rate base. However, it did not propose a corresponding adjustment to its total capitalization. ULH&P claims that because the jurisdictional rate base excludes facilities not devoted to Kentucky customers, any required adjustment to capitalization is made in determining the allocation ratio. Therefore, it contends that the application of the allocation ratio excludes the appropriate amounts from capitalization.[31]

Although the ratio is designed to establish the percentage of jurisdictional gas operations rate base, the approach suggested by ULH&P may cause some facilities not devoted to Kentucky customers to be allocated to electric operations instead of totally to gas operations. This approach has no effect on the total dollars of capitalization and thus would not reflect the elimination of certain gas operation assets. In order to maintain an appropriate match between the gas operations rate base and capitalization, the amounts removed from utility plant, accumulated depreciation, and propane inventory must be deducted from the capital assigned to gas operations. The Commission has reduced the $80,170,446 in capital by $3,431,443[32] leaving capital assigned to jurisdictional gas operations at $76,739,003.

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31 Response to the Commission's Order dated November 13, 1992, Item 24.

32 $5,143,461 in utility plant minus $3,302,635 in accumulated depreciation plus $1,590,617 in propane inventory equals $3,431,443.

The Commission has increased this by $2,268,387,[33] the jurisdictional amount of JDIC applicable to gas operations. The JDIC has been allocated to each component of capital based on the ratio of each to total capital excluding JDIC. Both ULH&P and the AG proposed including all investment tax credits as JDIC, without removing those included in the determination of rate base from the total or excluding the non-jurisdictional portion. They did not allocate the amounts to the components of capital, a practice the Commission has traditionally followed. We find no basis to depart from a practice which is entirely consistent with the requirements of the Internal Revenue Service that JDIC receive the same overall return allowed on the components of capitalization.

REVENUE AND EXPENSES

For the test period, ULH&P had actual gas jurisdictional net operating income of $4,514,662. It proposed several pro forma adjustments to revenues and expenses to reflect current and anticipated operating conditions. These resulted in an adjusted jurisdictional net operating income of $4,463,000.[34] The proposed adjustments are acceptable for rate-making purposes with the following modifications:

Revenue Normalization

ULH&P proposed to normalize its gas operating revenues at $64,950,798 based on the rates in effect at the end of the test

[33] Schedule B-6 of the Application, Account No. 255, 4 percent and 10 percent credits; allocation percentage from Transcript of Evidence ("T.E."), Vol. I, April 19, 1993, at 170.

[34] Schedule C-2 of the Application.

period.[35] In doing so, it annualized its sales to reflect normal weather conditions, eliminated unbilled revenues, and adjusted gas cost revenues based on its test-year-end wholesale gas cost. It also increased the level of late payment charges based on these revenue adjustments. In normalizing its other operating revenues, ULH&P annualized its revenues from rents from CG&E and eliminated revenues from facilities serving non-jurisdictional customers.

The AG argues that gas service operating revenues should be increased to recognize the customer growth that occurs throughout the test year and that such an adjustment is necessary in order properly to match plant, rate base, and operating revenues at test-year-end levels. Based on ULH&P's customer growth during the test-year heating season (October 1991 - March 1992), and assuming a ratable increase in customers during the test year, the AG calculated an increase in base revenues, exclusive of gas cost revenues, of $224,906.[36]

ULH&P argues that it is inappropriate to base such an adjustment on the number of customers as of March 31, 1992, when the end of the test period was June 30, 1992; that the AG made no evaluation of the October 1991 and March 1992 customer levels; and that no consideration was given to changes in customer levels within specific customer groups. ULH&P also argues that the AG made no attempt to evaluate any other months in the test period to demonstrate the validity or reasonableness of using the two selected. Finally, ULH&P claims the AG's adjustment is incomplete

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[35] Schedule C-1 of the Application.

[36] DeWard Direct Testimony, Exhibit TCD-1, Schedule 8.

without the inclusion of additional expenses related to the increase in the number of customers.

We agree with some of ULH&P's criticisms of the AG's methodology, particularly those concerning the analysis, or lack thereof, of using October and March to perform the adjustment and the failure to consider specific customer groups. The AG did not perform any analysis nor did he demonstrate how his methodology produces a result comparable to that which would be achieved if all months of the test year and the number of customers by specific customer group were used to calculate the adjustment. Lacking a reasonable basis upon which to accept the adjustment and finding both the methodology and result to be suspect, we deny the adjustment.

The AG also recommended reversing ULH&P's proposed adjustment to eliminate the revenues and expenses associated with facilities serving non-jurisdictional customers. This proposal accompanied the recommended reversal of ULH&P's adjustment to eliminate these facilities from rate base. For the same reasons given in our discussion of the proposed rate base adjustments, we accept ULH&P's proposal and reject the AG's recommendation.

ULH&P's normalized operating revenues of $64,950,798 included gas cost revenues of $37,503,206 based on its test-year-end wholesale gas cost. ULH&P's normalized revenues have been increased by $6,891,755 to reflect its latest gas cost adjustment and its purchased gas cost has been increased by a like amount.[37]

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[37] Case No. 90-041-L, The Notice of Purchased Gas Adjustment Filing of The Union Light, Heat and Power Company, Order dated June 25, 1993.

This gas cost revenue adjustment and the other revenue adjustments addressed herein, coupled with the related increases in late payment revenues, result in normalized revenues for rate-making purposes of $71,902,180.

Labor and Labor-Related Costs

ULH&P proposed adjustments to increase its test-year operating expenses by $254,351 for labor and labor-related costs. The adjustment included a $250,345 increase in wages and salaries and a related $4,006 increase in the Savings Incentive Plan ("SIP") and Deferred Compensation and Investment Plan ("DCIP").[38] It also proposed a $517,639[39] net reduction in operating expenses for costs and savings from its downsizing which occurred in the last quarter of 1992.

Wages and Salaries. ULH&P proposed an increase of $250,345 to annualize base wage increases granted to all employee groups during the test year. It multiplied the average hourly wage increase by the number of hours charged to gas operations, and then annualized the result by the appropriate number of months.

ULH&P provided workpapers which documented the monthly hours worked during the test year by its employees for its activities.[40] However, the reported hours included the hours worked by ULH&P employees for CG&E and on CG&E affiliate activities.[41] ULH&P also provided the total hours worked by CG&E and CG&E affiliate

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[38] Application Workpapers WPC-3.4a.

[39] Schedule C-3.2 of the Application.

[40] Application Workpapers WPC-3.4d through WPC-3.4o.

[41] Response to the Commission's Order dated October 21, 1992, Item 14.

employees for ULH&P activities.[42] ULH&P treats the hours its employees work for CG&E and CG&E affiliates as accounts receivable, and the hours CG&E and CG&E employees work for ULH&P as accounts payable. ULH&P also provided the monthly schedules of non-scheduled and compensated hours for ULH&P employees, to determine the number of hours for the allocation.[43]

One ULH&P workpaper showed the allocation of hours worked by bargaining groups and account distribution for the month of May 1992.[44] ULH&P bases its rate case allocation of labor hours on the distributions developed from this May 1992 data. It assigned hours to gas or electric operations, construction work in progress, retirement work in progress, accounts payable, and accounts receivable. ULH&P believes that it is appropriate to use the month of May for allocation purposes because it is "weather neutral," vacation time is at a minimum, and work activities performed reflect normal business operations.[45]

The allocation percentages used in the May labor analysis are based on annual time studies. The time studies related to union labor groups usually are documented by work orders. The time studies for supervisory, administrative, and professional employees are based upon an annual study performed in October of each year. ULH&P stated that the hours reported in this study by each employee

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[42] Id., Item 18.

[43] Id., Item 16 and Response to the Commission's Order dated November 13, 1992, Item 9.

[44] Application Workpaper WPC-3.4c.

[45] Response to the Commission's Order dated October 21, 1992, Item 20(c).

represent actual work performed during the historical 12-month period ended October 31, expressed as a "typical" month.[46] ULH&P explained that the reporting of hours for each employee based on a "typical" month of 173 hours was merely for cost allocation convenience.[47]

In Case No. 91-370, we expressed several concerns about the labor allocation process used and ULH&P has not changed its practices since that case.[48] Although ULH&P provided additional information concerning the allocation process during this proceeding, the Commission has several remaining concerns.

First, the workpaper allocating labor based on the month of May 1992, shows that the percentages are based on total hours worked by ULH&P employees for it and the accounts receivable hours. As a result, some of the account categories have percentages in excess of 100 percent. This approach "backs into" the allocation. ULH&P should start with all hours worked by its employees, subtract accounts receivable hours, and add in the accounts payable hours, thus providing the total hours to be charged to ULH&P operations. This figure should then be allocated to gas or electric operations, construction work in progress, and retirement work in progress.

Second, ULH&P has not supported using the month of May as the basis of the labor allocation. It was specifically asked when it or CG&E last determined that the month of May was most appropriate

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46 Steffen Direct Testimony, at 6.

47 Id.

48 Response to the Commission's Order dated October 21, 1992, Item 12.

but did not respond.[49] ULH&P agreed, subject to check, that the month of May had the fourth highest level of reported compensated hours.[50] ULH&P also agreed to clarify vacation hours for the test year,[51] but did not include this information with its responses to data requests.

Finally, the Commission is concerned over the approach used for the supervisory, administrative, and professional groups' time studies. While ULH&P contends that the "typical" month reflects actual work activities for the entire year, its outside auditor stated that the "typical" month represented an estimate of time spent.[52] It would be simpler and more direct to base the study on the total actual hours worked in the historic period. This should make the study easier to prepare, as those employees charging time to two or more activities would not have to restate their historic period hours in terms of a "typical" 173-hour month.

Wage normalization is an essential adjustment to reflect the appropriate level of expense in revenue requirements. However, the allocation processes used by ULH&P make it impossible to verify the reasonableness of the proposed adjustment. The Commission has calculated an adjustment as outlined above, taking the total hours worked by ULH&P employees during the test year,[53] subtracting the

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49 Id., Item 20(c).

50 T.E., Vol. I, April 19, 1993, at 37.

51 Id., at 38.

52 T.E., Vol. I, April 19, 1993, at 27.

53 Application Workpaper WPC-3.4d.

hours related to accounts receivable,[54] and adding the hours related to accounts payable.[55] The hours related to gas operations expense were then determined. Finally, the hours allocated to gas operations expense were multiplied by the average hourly wage increase[56] and annualized by the appropriate number of months. This results in an increase in gas operations expense of $116,535.

SIP and DCIP. ULH&P proposed an increase of $4,006 for its SIP and DCIP. Executive, supervisory, administrative, and professional employees can participate in DCIP, while other employees can participate in SIP. ULH&P determined the increase by applying a cost percentage to its proposed wage normalization adjustment.[57] The percentage used was determined by dividing the total required contribution by ULH&P for SIP and DCIP by total labor costs, because ULH&P reasons that as wages increase, contributions to the plans must also increase.[58]

Because ULH&P's proposed adjustment was based on its wage and salary normalization, we have recalculated it following ULH&P's methodology and using the wage normalization adjustment granted. This results in an increase in gas operating expenses of $1,865.

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54 Response to the Commission's Order dated October 21, 1992, Item 17.

55 Id., Item 18.

56 Application Workpaper WPC-3.4a.

57 Id.

58 Response to the Commission's Order dated October 21, 1992, Item 13.

Key Employee Annual Incentive Plan ("KEAIP"). The AG proposed to remove $17,166 associated with the KEAIP from test-year operating expenses. He argues that, given the rate increase sought and the downsizing undertaken by ULH&P, it would be inappropriate for ULH&P to recover any amount of incentive compensation above normal salary levels.[59] ULH&P offered no rebuttal.

In Case No. 91-370, we expressed several concerns about the KEAIP and excluded the test-year KEAIP expense for rate-making purposes.[60] After reviewing the KEAIPs for fiscal years 1991 and 1992,[61] the Commission finds that its concerns are still valid. We have also examined the compensation analysis provided by ULH&P[62] and believe that the overall benefit package for key employees, exclusive of the KEAIP payments, is quite adequate.

Overtime Labor. The AG proposed to reduce test-year overtime expense by $360,918, to reflect ULH&P's May 1992 announcement that all overtime except for emergencies was being eliminated.[63] ULH&P proposed a reduction in overtime of $90,000, which was related to its downsizing adjustment.[64] ULH&P claims that the complement reduction in the downsizing adjustment reflects additional

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59 DeWard Direct Testimony, at 16.

60 Case No. 91-370, final Order dated May 5, 1992, at 31-32.

61 Response to the Commission's Order dated October 21, 1992, Item 68.

62 Id., Item 66.

63 DeWard Direct Testimony, at 14.

64 Application Workpaper WPC-3.2a.

reductions in overtime and that the AG's proposal duplicates expenses already removed from the test year.[65]

The effects of the overtime elimination should be reflected for rate-making purposes. We do not view an adjustment to overtime above the amount recognized in the downsizing adjustment would be duplicative. No evidence was produced which supports the claim that additional overtime reductions were included in the reduction to complement calculations. Nor do we accept the approach used by the AG. The percentage used by him to reflect a reasonable level of overtime has not been adequately supported in the record.

The Commission has reduced operating expenses for rate-making purposes by $152,129 based on annualization of the time and one-half and double time hours reported for the months of May through September 1992. In determining the adjustment, the Commission has recognized the level of overtime expense removed as part of the downsizing expense reduction. The calculation of the adjustment is contained in Appendix C.

Accrual of Vacation Time. The AG proposed to reduce the test-year operating expense for the accrual of vacation time by $100,342. He stated that analysis of the test-year expense shows a significant increase in accruals in general and a sizable accrual in the month of December 1991. ULH&P offered no rebuttal.

The AG's proposal may have merit in theory, but has not been adequately developed. Numerous factors can affect the amounts recorded as monthly accruals. This adjustment should not be based

[65] Lonneman Rebuttal Testimony, at 6-7.

solely on fluctuations noted in the monthly account accruals. Therefore, we reject the AG's proposal.

Meter Reading Workforce Reduction. In October 1991, as part of its review of meter reading routes, ULH&P reduced its meter reading workforce by four employees. The annual gas operations expense reduction was $49,637.[66] The test year only reflected 75 percent of this annual expense reduction, and ULH&P was asked why it did not normalize the reduction.[67] ULH&P claimed that its downsizing adjustment encompassed the meter reading adjustments, because it had looked at the total workforce complement in the downsizing.[68]

The downsizing at ULH&P occurred a full year after the reduction in meter readers. ULH&P has offered no evidence to demonstrate that 25 percent of the annual expense reduction was incorporated into the downsizing adjustment. Therefore, the Commission will reduce operating expenses by $12,409.[69]

Uncollectible Accounts

As in past cases, ULH&P included in its requested revenue increase a commensurate increase in its provision for uncollectible accounts. This proposed increase was based upon a test-year provision for uncollectibles viewed as a percentage of total revenues, 1.06 percent,[70] which reflects both gas and electric

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66 Response to the Commission's Order dated October 21, 1992, Item 30.

67 Id.

68 Id. and T.E., Vol. I., April 19, 1993, at 175.

69 $49,637 multiplied by 25 percent equals $12,409.

70 Application Workpaper WPC-12a.

operations. The test-year gas provision for uncollectibles was 1.25 percent.[71] Although we accept this methodology, we have determined ULH&P's revenue requirement using 1.25 percent to reflect the increase in uncollectible accounts expense associated with the revenue increase granted herein.

PSC Assessment

ULH&P included in its requested revenue increase a commensurate increase in the PSC Assessment expense based upon the rate in effect for Kentucky's 1992-93 fiscal year, which began on July 1, 1992. On July 1, 1993, the PSC Assessment rate of .1599 percent effective for the 1993-94 fiscal year was announced. The Commission traditionally recognizes the change in this cost when determining a utility's revenue requirements. The Commission accepts this proposal and has normalized the assessment based on the normalized revenues as adjusted in this Order.

Downsizing Savings and Costs

In the last half of 1992, ULH&P and CG&E undertook a long-term cost reduction review, with a primary focus on total corporate workforce levels. ULH&P analyzed work activities, spans of control, and professional employees.[72] The review resulted in a corporate reorganization and the elimination of 406 positions[73] from the consolidated CG&E operations. CG&E offered early retirement to its employees 55 years of age and older and 464 accepted the plan. An additional 68 employees were involuntary

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[71] Response to the Commission's Order dated October 21, 1992, Item 47.

[72] Marshall Direct Testimony, at 6-7.

[73] Lonneman Rebuttal Testimony, at 10.

separated.[74] The number of ULH&P employees involved in its gas operations included in these numbers is not known.[75]

ULH&P proposed an adjustment to recognize its allocated share of the savings and costs resulting from the downsizing. It estimated a reduction in annual labor expense for complement, overtime, and travel of $968,736.[76] ULH&P estimated the total cost of the early retirement and involuntary separation to be $1,009,887, which it proposed to recover over three years.[77] It also estimated an increase in annual pension cost of $114,468.[78] These components resulted in a net reduction in annual expenses of $517,639.[79] ULH&P later revised the reductions for complement, overtime, and travel to $1,246,554,[80] and total costs of the early retirement, involuntary separation, and consultants to $1,522,830.[81] It also proposed to include the unamortized portion of its downsizing costs in its rate base.

The AG opposes including the downsizing costs for rate-making purposes. He argues that ULH&P's ratepayers should not be responsible for these costs, because the workforce reduction was

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74 Id.

75 T.E., Vol. I., April 19, 1993, at 179-180.

76 Application Workpaper WPC-3.2a.

77 Application Workpaper WPC-3.2b.

78 Id.

79 Schedule C-3.2 of the Application.

80 Response to April 19, 1993 Hearing Request, filed May 4, 1993, at 4-7.

81 Response to the Commission's Order dated February 10, 1993, Item 3(a).

undertaken by CG&E after it had failed to obtain increased rates in Ohio. The AG also makes the facile argument that if ULH&P can simply reduce its workforce, there must have been an excessive employee complement prior to the downsizing and that ratepayers should not pay for any cost to terminate unnecessary employees.[82] However, the AG provided no analysis to support his implied assertion that ULH&P had excessive employees and we are loath to discourage the sort of cost conscious review which led to the downsizing.

It is appropriate to reflect the downsizing savings and the amortization of the associated costs for rate-making purposes. However, we are not persuaded that the savings should be adjusted as claimed by ULH&P or that the amortization period should be 3 years. When ULH&P provided the actual savings information, it reduced the total savings by $88,597 for labor costs it claimed would increase due to the Commission's rejection of a deviation sought in Case No. 92-381.[83] ULH&P has not documented here or in Case No. 92-381 that the estimated savings that would have resulted from the deviation would have related exclusively to labor or labor-related costs. ULH&P has also failed to support the use of the 3-year amortization.

It is appropriate to recognize the actual downsizing savings of $1,335,151 for rate-making purposes and the actual downsizing costs of $1,522,829 both as determined by ULH&P. However, the

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[82] DeWard Direct Testimony, at 15-16.

[83] Case No. 92-381, The Application of The Union Light, Heat and Power Company for Authority to Implement a Gas Services Safety Inspection Pilot Program, final Order dated January 19, 1993.

costs should be amortized over two different periods. Those downsizing costs which reflect an immediate cash outlay should be amortized over a 3-year period. Those which may require cash outlays for at least 10 years[84] should be amortized over a 10-year period. (As discussed earlier in this Order, we have not included the unamortized balance of the downsizing costs in the determination of ULH&P's rate base.)

Based on the evidence of record, the Commission has determined that downsizing costs of $1,522,829[85] should be amortized, with an annual amortization expense in the first year of $186,823 as shown in Appendix D. We have also included $114,468 in additional annual pension costs for ULH&P.

The Commission expects that both ULH&P's ratepayers and shareholders will continue to enjoy future benefits from the reduced staffing levels. We will monitor ULH&P's management of its workforce, particularly any future increase in staffing levels which may tend to mitigate the benefits achieved by the downsizing. We would anticipate that ULH&P will continue to ensure that its workforce levels are properly controlled and aggressively managed.

Rate Case Expense

ULH&P proposed an increase to operating expenses of $109,373 for its estimated cost of this rate case and the unamortized gas operations balance of the actual rate case cost for Case No. 90-041. The proposal was reduced by $635 of test-year expenses,

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[84] Response to the April 19, 1993 Hearing Request, filed May 4, 1993, eighth page.

[85] Difference from ULH&P filed amount due to decimal rounding.

resulting in a net adjustment of $108,738.[86] ULH&P claimed that the gas portion of the actual rate case costs in Case No. 90-041 was $39,496, while the gas portion of estimated rate case cost was $25,000.[87] The AG proposed an increase of $26,666,[88] to be amortized over a 3-year period. The AG argued that ULH&P had not adequately justified using outside counsel when it appeared that house counsel had ample time to present the case.[89]

Throughout this proceeding, the Commission required ULH&P to provide the current actual rate case cost, with adequate supporting documentation. ULH&P filed its last update with the Commission on March 9, 1993, showing actual rate case costs of $34,591.

It would not be reasonable for ULH&P to recover the costs of this rate case every year that the rates established by it are in effect. Nor would it be reasonable to use estimated costs when the actual cost is known. It would be equally inappropriate for ULH&P to recover rate case costs for Case No. 90-041 in this proceeding which exceed the amount authorized in that proceeding nearly three years ago. ULH&P admitted that it had not supplied any documentation to support its current claim that the rate case expense was $39,496.[90]

We feel it is appropriate to amortize the $34,591 in actual costs over a 3-year period. Approximately $1,389 of the amount

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86 Application Workpaper WPC-3.3a.

87 Response to the Commission's Order dated November 13, 1992, Item 3.

88 DeWard Direct Testimony, Exhibit TCD-1, Schedule 14.

89 Id., at 19.

90 T.E., Vol I., April 19, 1993, at 45.

authorized for gas rate case expense amortization in Case No. 90-041 is currently outstanding. This amount should also be amortized over the 3-year period these rates should reasonably be expected to be in effect. This results in an annual amortization, and increase in gas operating expenses, of $11,993. (As noted earlier, the unamortized balance of the Case No. 90-041 rate case expenses has not been included in rate base.)

Amortization of Management Audit Cost

ULH&P proposed to increase operating expenses $34,221 for annual amortization of its management audit costs. In Case No. 90-041, the Commission approved ULH&P's proposal to amortize $257,067[91] in management audit costs over a 3-year period. ULH&P also proposed to include the unamortized portion of the management audit expenses in rate base.

ULH&P is entitled under the management audit statute to recover the total cost of the management audit, but no more. At the present amortization rate, ULH&P will have recovered the cost by October 1993. To avoid over-recovery, the amortization rate must be adjusted. Approximately $5,723 of the management audit costs allocated to gas operations is unamortized to date and should be amortized over a 3-year period. Therefore, the Commission has increased operating expenses by $1,908. (As discussed earlier, the unamortized balance of this expense has not been included in rate base.)

[91] Case No. 90-041, Application Workpaper WPC-3.6a, as accepted in final Order, October 2, 1990.

Depreciation Expense

ULH&P proposed to increase depreciation expenses by $751,322.[92] The adjustment reflected normalization of depreciation expense on utility plant in service at test-year end, net of any utility plant identified as not devoted to Kentucky customers. The depreciation accrual rates used in the calculations were from ULH&P's recently completed depreciation study filed with the Commission on July 29, 1992. ULH&P's previous depreciation study had been performed in the 1970s.[93]

We note the new depreciation study is based on the remaining life methodology, as was ULH&P's previous study. The documentation contained in the 1992 study did not contain historic salvage value data for four ULH&P plant group accounts and therefore fails to support the net salvage accrual rates determined for them.[94] As a result, we have recalculated the adjustment, using the 1992 study for all plant group accounts except those four. For them the previous depreciation accrual rates were used. This calculation results in an increase in depreciation expense of $522,788.

Interest Synchronization

ULH&P proposed to adjust its interest expense used to compute pro forma state and federal income tax expense. It multiplied the long-term debt component of its pro forma capitalization by the weighted cost of long-term debt. The gas portion of the product

92 Schedule C-7 of the Application.

93 T.E., Vol. I., April 19, 1993, at 12-13.

94 ULH&P Plant Group Accounts No. 2531 - Mains, Cast Iron and Copper; No. 2532 - Mains, Steel; No. 2533 - Mains, Plastic; and No. 2591 - Services, Cast Iron and Copper.

was then determined by applying a ULH&P-determined ratio of gas operations rate base to total company rate base.[95] The test-year actual interest expense was deducted from the pro forma gas amount to arrive at the adjustment to interest expense for the computation of income taxes. ULH&P's total capitalization reflected the post-test-year $20 million bond sale, the $15 million sale of common stock, and the total test-year amount for investment tax credits.[96] It did not include a component for short-term debt.

The AG proposed to reduce tax expense by $76,703. Starting with ULH&P's proposed rate base, he proposed various adjustments. He then multiplied the adjusted rate base by his recommended weighted cost of debt. The difference between this amount and the interest expense used by ULH&P was multiplied by the blended state and federal income tax rate.[97]

An interest synchronization is typically required to ensure that adjustments to the utility's proposed interest expense, which is a below the line expense, is properly reflected as a deduction for income taxes, an above the line expense. Interest synchronization must reflect a number of factors, including the debt component of the capital structure, JDIC, and Construction Work in Progress ("CWIP") subject to Allowance for Funds Used During Construction ("AFUDC"). ULH&P's calculation is similar to that used by the Commission in ULH&P's prior cases. For rate-making purposes, the Commission has historically imputed interest

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[95] Application Workpapers WPC-3.10a and WPC-3.10b.

[96] Schedule D-1 of the Application, page 1 of 2.

[97] DeWard Direct Testimony, at 24-25.

expense on the portion of JDIC assigned to the debt components of the capital structure and treated the interest as a deduction in computing the income tax expense allowed in the cost of service. The amount included as JDIC does not include those investment tax credits included in the determination of rate base nor the non-jurisdictional portion of gas investment tax credits, above.

ULH&P takes issue with the Commission's past treatment of the AFUDC and the related amount of CWIP. It argues that including all gas plant CWIP in the determination of the interest synchronization allows a tax benefit from the interest cost to flow to customers. However, ULH&P claims that such a benefit to customers is inappropriate under the current Internal Revenue Code, which requires ULH&P to capitalize interest related to AFUDC. Thus, there is no deduction for interest permitted during the construction period.[98]

The Commission has considered these arguments and agrees that in determining the interest synchronization adjustment, the debt portion of CWIP subject to AFUDC should be excluded because the capitalized interest is not tax deductible. In doing so, we have determined the interest synchronization as follows. Using the adjusted capital structure allowed, we have determined the long-term and short-term debt components which include JDIC to be 46.9 and 6.3 percent, respectively. Of the total $3,236,000 gas CWIP subject to AFUDC, the long-term debt portion is $1,517,684, and the short-term debt portion is $203,868. These debt portions are then deducted from the debt components gas capitalization allowed.

98 Lonneman Direct Testimony, at 17- 18.

ULH&P determined the actual gas interest expense applicable to Kentucky jurisdictional operations during the test year to be $3,536,270.[99] Using the adjusted capital structure allowed, excluding an appropriate amount for the gas CWIP subject to AFUDC, and using applicable cost rates for the debt components, the Commission has computed an interest expense reduction of $65,918, which results in an increase to income tax expense of $26,001 as shown in Appendix E.

Selling, Community Service, and Public Relations Expenses

ULH&P proposed to remove $193,055 in operating expenses, stating that the adjustment was consistent with the Commission's Orders in prior ULH&P proceedings.[100] The AG proposed an adjustment of $390,757, stating that many of the account descriptions indicated these expenses were for retention of current gas customers and for securing additional customers, expenses not allowed for rate-making purposes by Commission regulations.[101]

Several of the expenses included in the AG's proposal are included in ULH&P's proposal. The record has not been adequately developed to support the remainder of the AG's proposal. Account descriptions are not normally a sufficient basis to support adjustments. Rather, the transactions recorded within the accounts are usually reviewed before excluding specific costs. Therefore, we accept ULH&P's proposed adjustment and have also removed an

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99 Application Workpaper WPC-3.10a.

100 Schedule C-3.11 of the Application and Bruegge Direct Testimony, at 21.

101 DeWard Direct Testimony, pages 20 and 21, and Exhibit TCD-1, Schedule 17.

additional $242[102] of expenditures not related to the provision of gas service.

Injuries and Damages

ULH&P proposed to increase its operating expenses by $115,839[103] for injuries and damages to reflect its 10-year average expense. In its calculation, ULH&P used the calendar year average Consumer Price Index - Urban ("CPI-U") for 1982 through 1991 and the June 1992 CPI-U value for the six months of 1992. ULH&P used the average values to smooth out seasonal fluctuations.[104] However, it is not appropriate to use the average annual CPI-U values for most of the adjustment and then use a one month value as the base CPI-U value. The Commission has recalculated the adjustment, using the December CPI-U value for calendar years 1982 through 1991 and the June 1992 CPI-U value for the six months ending on June 30, 1992, for an increase in operating expenses of $113,209.

Hartwell Recreation Center ("Hartwell")

The AG proposed to reduce operating expenses $27,247 for costs associated with operating and maintaining Hartwell. As noted in Case No. 91-370, the costs to maintain recreation centers should not be included for rate-making purposes. While these expenses may

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102 Account No. 4930-0050: Cincinnati Historical Society, Greater Cincinnati Convention, and Japan Society of Greater Cincinnati. Information from the Response to the Commission's Order dated September 30, 1992, Item 24(b), at 15-16 of 16.

103 Revised proposal response to the Commission's Order dated October 21, 1992, Item 33(a), Sheet 3 of 6.

104 Response to the Commission's Order dated November 13, 1992, Item 19.

benefit employer-employee relations, the ratepayers should not bear these costs.[105]

Miscellaneous Expenses

The AG proposed to reduce expenses by $78,676 to exclude $29,720 to investigate gas storage in Kentucky and $48,956 from the allocation of salaries and expenses of the Public Affairs Department. The AG argued that the investigation charges were not recurring and that, without a direct showing of benefit to Kentucky ratepayers, the allocation was inappropriate for rate-making purposes.[106]

As recording an expense as a single accounting entry in the middle of the test year does not automatically indicate the expense is non-recurring,[107] and as the reasonableness of expenses is not normally determined solely on the basis of account descriptions, we have not included these adjustments.

AFUDC

The AG proposed an offset to ULH&P's revenue requirements associated with including CWIP subject to AFUDC in rate base. He asserts that a $403,972 reduction in revenue requirements is necessary to prevent ULH&P from receiving a double recovery when ratepayers pay a full return on CWIP subject to AFUDC and, at the same time, ULH&P continues to accrue AFUDC on the CWIP.[108]

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[105] Case No. 91-370, final Order dated May 5, 1992, at 47.

[106] DeWard Direct Testimony, at 22.

[107] Response of the AG to the Commission's Order dated January 6, 1993, Item 17.

[108] DeWard Direct Testimony, at 19-20.

ULH&P stated that the adjustment was not appropriate and that the method used by the Commission in the past penalized its construction program.[109] ULH&P explained that including the debt component of the CWIP subject to AFUDC in the interest synchronization calculation inappropriately passed a benefit to ratepayers because the Internal Revenue Code required interest on this debt to be capitalized.[110] ULH&P suggested a three part approach to eliminate these penalties. First, the only CWIP reflected in rate base would be that placed in service by the time of the public hearing. Second, CWIP subject to AFUDC would continue to accrue AFUDC but would not be included in rate base. Finally, the interest computations would be modified to reflect the rate base changes and the AFUDC offset to earnings would be discontinued.[111]

The Commission has previously reviewed the interest synchronization adjustment and modified the calculation to remove CWIP subject to AFUDC from the debt component of capitalization. ULH&P's remaining arguments appear to be based on a perceived inequality between the rate of return granted on capitalization and the resulting rate of return on net original cost rate base. ULH&P's revenue requirements have traditionally been based on the rate of return on capitalization. Its lament that it has been penalized due to the difference between these rates of return is without merit. If a utility is allowed to include the balance of

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109 Lonneman Direct Testimony, at 15.

110 Id., at 18.

111 Id., at 20.

all CWIP including the CWIP subject to AFUDC in its rate base at test-year end, a corresponding adjustment must be recognized in the revenue requirements to achieve proper matching.

This practice is consistently applied by this and other regulatory commissions and ULH&P has supplied no authority to refute such a practice. Including CWIP placed in service by the time of a public hearing in rate base constitutes a post-test-year plant adjustment. Such an adjustment is not permitted in a historic test period filing without adjustments to update all revenues, expenses, rate base, and capital.

In accordance with past practice, the Commission has computed an AFUDC offset adjustment. As revenue requirements are being determined from capitalization, we have applied the rate of return on capitalization granted here to the gas CWIP subject to AFUDC. This results in an increase in net operating income of $322,371[112] for rate-making purposes.

The Commission, after consideration of all pro forma adjustments and applicable income tax effects, has determined ULH&P's adjusted net operating income to be as follows:

Operating Revenues	$71,902,180
Operating Expenses	-66,685,880
AFUDC Offset	+ 322,371
Net Operating Income	$ 5,538,671

RATE OF RETURN

Capital Structure

ULH&P proposed to use its actual capital structure as of June 30, 1992 adjusted for the subsequent sale of first mortgage

112 $3,236,000 times 9.962% = $322,371.

bonds and issuance of common stock, resulting in 50.3 percent long-term debt and 49.7 percent common equity.[113] The AG recommended a capital structure of 50.8 percent long-term debt, 42.2 percent common equity, and 7.0 percent short-term debt.[114] The AG used the principal value of long-term debt outstanding rather than carrying value, excluded $15 million in equity financing, and included short-term debt. In calculating the short-term debt component, he used short-term debt outstanding at June 30, 1992, less the proceeds of the bond issue intended to retire it.

The Commission finds that a capital structure consisting of 46.9 percent long-term debt, 6.3 percent short-term debt and 46.8 percent common equity is most reasonable for ULH&P. The short-term debt component is a simple average of ULH&P's proposed proforma balance as of June 30, 1992 and the actual average short-term debt for the test year. This recognizes ULH&P's consistent use of short-term debt and its post test-year issues of long-term debt and common stock.

Cost of Debt

ULH&P proposed a 9.2 percent cost of long-term debt based on the carrying value of its debt issues. Because it did not include short-term debt in its proposed capital structure, short-term debt cost was not included in its rate of return calculation.

The AG proposed a 9.16 percent cost of long-term debt based on outstanding principal and yield to maturity. He recommended

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113 Calculated from ULH&P Exhibit JRM, page 1 of 26, filed September 30, 1992.

114 Calculated from AG Exhibit C.G.K. Weaver Statement 22, filed December 10, 1992.

including a 4.21 percent short-term debt cost in the capital structure.

ULH&P's calculation of its embedded cost of long-term debt is consistent with its last rate case, and should be approved at a cost of 9.2 percent. The cost of short-term debt is 4.21 percent, which is the actual interest paid or accrued on short-term debt during the test year.

Return on Equity

ULH&P proposed a return on common equity in the range of 12.5 to 13.5 percent. The AG recommended a return in the range of 10.1 to 11.1 percent.

The Commission has removed ULH&P's proposed flotation cost and quarterly dividend adjustments. The use of a flotation cost adjustment would overstate ULH&P's required return on equity. Use of the quarterly dividend model is not appropriate because investors would be doubly compensated. Although the Commission does not ordinarily adjust return to compensate shareholders for a greater degree of uncertainty when one utility is compared to others chosen for similar credit ratings, additional risk is present in this case. An environment of risk has been created for ULH&P by a number of factors including a possible change in corporate structure by its parent.

The Commission, having considered all the evidence, including current economic conditions, finds that a return on equity of 11.25 to 11.75 percent is fair, just, and reasonable. This range will allow ULH&P to attract capital at a reasonable cost and maintain its financial integrity, ensuring continued service. It will provide for necessary expansion to meet future requirements, and result in the lowest possible cost to ratepayers. A return of 11.5 percent will best meet the above objectives.

Rate of Return Summary

Applying the rates of 9.20 percent for long-term debt, 4.21 percent for short-term debt, and 11.50 percent for common equity to the capital structure, produces an overall cost of capital of 9.96 percent, which we find to be fair, just, and reasonable. This cost of capital produces a rate of return on ULH&P's jurisdictional net cost rate base of 9.37 percent.

REVENUE REQUIREMENTS

ULH&P needs $2,332,069 additional annual operating income to produce a 11.50 percent rate of return on common equity based on the adjusted historical test year. After the provision of state and federal taxes, PSC Assessment, and increased uncollectibles, there is an overall revenue deficiency of $3,906,279. The net operating income necessary to allow ULH&P the opportunity to pay its operating expenses and fixed costs and have a reasonable amount for equity growth is $7,870,740. The required operating income and the revenue increase are calculated as follows:

Net Operating Income Found Reasonable	$7,870,740
Adjusted Net Operating Income	-5,538,671
Net Operating Income Deficiency	2,332,069
Gross Up Revenue Factor for Taxes, PSC Assessment, and Uncollectibles	x 1.67503
Additional Revenue Required	$3,906,279

Based on the adjusted test year, the rates and charges in Appendix A are designed to produce gross operating revenues of $75,808,459.

OTHER ISSUES

Cost-of-Service Studies

Both ULH&P and the AG submitted cost-of-service studies. The AG's evidence reflected that it was unlikely that 77 percent of ULH&P's directly assigned labor costs were in the area of customer accounting.[115]

ULH&P's Cost-of-Service Study

There are three major issues concerning ULH&P's revised cost-of-service study: the use of data outside the test year, the derivation of allocators and application of zero-intercept methodology results to them, and the construction of an allocator for certain production expenses.

ULH&P used 1991 FERC Form 2 data to construct the K411 allocator, which assigns administrative and general expenses among customer classes.[116] However, the test year contains 6 months of labor data not accounted for by the 1991 Form 2 data, which in turn includes 6 months of data outside the test year. Because it is so expensive, ULH&P produces the labor dollar amounts for Form 2 only once per year. It compared the monthly figures for 1990-92 and asserted that the percentages changed very little.[117] However, monthly labor data regarding production, gas supply, distribution, and customer accounting categories exists. As Newport Steel's evidence shows, there must be some cutoff for updating data when conducting a cost-of-service study. However, both ULH&P and

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115 See Mr. Kinloch's testimony filed December 9, 1992, at 6, Lines 11-16.

116 Revised Exhibit PVC-P&A, schedule 14, page 6 of 11.

117 Also see ULH&P's comment in Item 53, filed November 23, 1992.

Newport Steel agree that, when it exists, actual data is preferable to estimates.[118]

ULH&P has not filed monthly labor figures or any other study which supports the assertion that the labor percentages from the Form 2 data are identical to test-year percentages.[119] It remains unclear from the record why the cost to collect existing monthly labor totals is unduly burdensome. Therefore, the K411 allocator based upon Form 2 labor data should be rejected.

ULH&P uses the zero-intercept method to calculate customer and demand component percentages of gas mains in the ground.[120] These percentages are then used to calculate the K415 and K411 allocators. ULH&P omitted certain pipe sizes from the regression analysis but not from the total cost calculations. The AG stated that the omission[121] may skew the customer portion of the total historical or embedded cost of gas mains. ULH&P claimed[122] that it included in the regression only pipe sizes currently being installed. Contrary to this claim,[123] the cost of these pipe

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118 T.E., Vol. I, at 67 and Vol. II, at 16-17, respectively.

119 T.E., Vol. I, at 66. ULH&P was aware of the Commission's concern regarding the use of Form 2 data instead of actual test year data; yet ULH&P did not support its assertion that use of actual data would have made no difference to the labor percentages.

120 Revised Exhibit PVC-P&A schedule 14, page 9 of 11.

121 See David H. Kinloch's testimony, at 14-15.

122 See Item 90(b), filed November 4, 1992 and T.E., Vol. I, at 71-75. Item 90(b) was actually prepared by Mr. Lonneman, but adopted by Mr. Van Curen.

123 Id., at 72-3.

sizes was actually included in the total cost calculations from which the customer and demand percentages were determined.

ULH&P further claimed[124] that it rounded the customer and demand components to maintain consistency with past practices. The regression analysis results yielded customer and demand percentages of 16 and 84 respectively which ULH&P rounded to 20 and 80 percent respectively. According to ULH&P, failure to emulate past practices could cause drastic changes in allocators, change the cost responsibility of each customer class, and cause usage variations in rate design from case to case.

A cost-of-service study is intended to allocate costs among various customer classes as accurately as possible. Within this process, judgment must be exercised when there is no clear path or direction. However, customer class responsibility for utility costs may change over time. Dogmatic adherence to a traditional allocation rationale could result in an erroneous study. While it is reasonable to round numbers when they are close to historical trends or levels, it is unreasonable to round the customer percentage up from 16 to 20 percent - a 20 percent increase in the customer component.

By rejecting the regression results and rounding the customer component to 20 percent, ULH&P implies that there may be a systematic downward bias inherent in the allocation procedure. It would be better to solve this problem, rather than round estimates to an unsupportable system level. As these percentages are used to determine allocators K415, K411 and K417, even small rounding

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[124] T.E., Vol. I, at 73-75.

decisions can have a compound effect upon the final allocation of costs among rate classes. The allocators should be rejected.

The final issue connected with the cost-of-service study is the construction and use of the K205 allocator. ULH&P constructs two allocators, K203 and K205 in Revised Exhibit PVC-P&A schedule 14, page 5 of 11. In Case No. 90-041, ULH&P submitted three cost-of-service studies based upon three separate demand allocators and the peak and average method was selected for rate design purposes. Although this method is used here to construct both K205 and K203, the transportation sector is omitted from the K205 equation.

The AG argues that use of the peak and average method is inappropriate. Being a compromise allocator, it should be applied to demand related items to be allocated on a coincident peak ("CP") basis, as well as those allocated on a non-coincident peak ("NCP") basis. However, ULH&P applies K203 to NCP demand items and K205 to CP demand items. To use this method properly, K203 should be applied to all demand items.[125]

The AG argued that using two separate demand allocators allowed transportation customers to escape their proper share of demand costs. Newport Steel agreed that if a compromise allocator is used, it should be applied to all customer classes.[126]

ULH&P's use of the peak and average method to allocate demand related costs is a proper compromise between the theoretical and philosophical shortcomings of the CP and NCP methods. However, ULH&P violated the intent of a compromise methodology by applying

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125 See Mr. Kinloch's testimony, at 12, the first full paragraph.

126 T.E., Vol. II, at 20.

two allocators rather than applying the K203 allocator to all items. Thus, ULH&P's cost-of-service study should be rejected.

The AG's Cost-of-Service Study

The AG filed an alternative cost-of-service study. It raises three primary issues: the reallocation of certain customer service and information expenses in ULH&P's allocator K405, construction and application of a NCP allocator, and the use and application of the minimum size methodology.

In the AG's view, ULH&P's K405 inappropriately allocated certain marketing costs in the subaccounts of accounts 907-909 to the residential customers. These costs could either be directly assigned or allocated to other customer classes. Of $829,938 customer service and information costs, the AG directly assigns $123,345 to the residential class. He uses three specific sub-accounts, 908-30, 31 and 32, to apportion and directly assign $500,433 to the other customer classes except transportation. This adjustment assumes that the entire $500,433 cost responsibility is generated in the same proportion as the three sub-accounts and that the residential sector bears none of it. K405 is used to allocate the $206,160 balance. However, there is no basis in the record for either of the AG's assumptions.

The second issue concerns the derivation and use of a NCP demand allocator. The AG argues that both the American Gas Association's ("AGA") Gas Rate Fundamentals text and the NARUC Gas Distribution Rate Design Manual recommend using CP and NCP allocators for selected demand items.[127] Newport Steel argues

[127] See Mr. Kinloch's testimony, at 12-13.

that the AG misinterprets the AGA and NARUC text discussion as "recommending" the use of CP and NCP allocators and that use of customer class monthly billing data is not appropriate for the construction of NCP allocators. Typically, NCP allocators are constructed using class peak day or hour load data rather than monthly data because it masks the fact that a high load factor customer will have a proportionately lower share of the system peak day gas send out than a low load factor customer. Therefore, higher load factor customers (industrial and transportation) will be allocated excess demand expenses while lower load factor customers (residential and commercial) will receive less than their fair share.

The Commission agrees that use of monthly data to construct NCP allocators is inappropriate, because the results will be unreasonably biased against relatively high load factor customers. The A203, A415 and A417 allocators should be rejected.

Finally, the AG cites NARUC's <u>Gas Distribution Rate Design Manual</u> to justify use of minimum size as an alternative to the zero-intercept method in the A415 allocator. One inch pipe is said to represent ULH&P's minimum installed size pipe.[128]

Newport Steel argues that the AG, again, has misinterpreted the NARUC manual and misapplied the methodology.[129] It points out that selection of one inch pipe is completely arbitrary because one inch pipe comprises 0.03 percent of ULH&P's total system and is not the minimum size used in the system. Clearly, it is more

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[128] See Exhibit DHK-5 in Mr. Kinloch's testimony for the minimum system cost calculations.

[129] See Mr. Baudino's testimony, at 14-15.

appropriate to use only equipment currently being installed on the system with the minimum size method.[130] Therefore, the A415 allocator should be rejected, and based upon the foregoing, the AG's tendered cost-of- service study should also be rejected.

Revenue Allocation and Rate Design

Having rejected the cost-of-service studies sponsored by ULH&P and the AG, the Commission will allocate the revenue increase in proportion to each customer class's contribution to ULH&P's total gas operating revenues. This approach, used in ULH&P's last electric case, requires all customer classes to bear the same approximate percentage increase, in this instance, approximately 5.5 percent.

ULH&P proposed that both the residential ("RS") and general service ("GS") customer charges be increased by the same approximate percentage as the overall revenue increase with the remainder of each class's increase allocated to its commodity charges. For transportation customers, ULH&P proposed to allocate the proposed increase entirely to the commodity charge. The intervenors offered no alternative rate design proposals. Given our decision on revenue allocation, ULH&P's rate design proposals are acceptable as they will maintain the existing relationships between rate classes.

Interruptible Transportation Service

ULH&P proposed several modifications to its tariff for interruptible transportation service ("Rate IT"). The most significant dealt with the provision that allows ULH&P to flex its

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[130] NARUC's Electric Utility Cost Allocation Manual, at 90-92.

transportation rate to meet competition from alternate fuels. At present, ULH&P can flex only when a customer states by affidavit that, absent a lower transportation rate, it will use an alternate fuel source. The customer must agree to pay a flexible rate for 12 months, assuming the risk that its transportation rate might subsequently exceed the fixed transportation rate, up to the GS commodity base rate.

ULH&P proposed to eliminate the customer affidavit and the required 12-month flex period and to impose a minimum flex rate of $.030 per CCF. Under the existing tariff, some customers may prefer to switch to alternate fuels for short periods rather than risk market-based pricing for the extended period. ULH&P believes that its market information will allow it to establish workable monthly transportation rates but, by its own admission, it does not possess the information necessary to verify its customers' alternate fuel costs.[131]

The Commission is not persuaded that ULH&P's market information should be substituted for the current affidavit process. Review of customer affidavits has proven to be of great value in other rate cases and the process should continue.

The Commission recognizes that customers may be reluctant to risk widely fluctuating flex rates for a 12-month period and that ULH&P desires to have a minimum level below which the rate would not flex. The following modifications are similar to tariff provisions approved for other utilities, address these issues, and are acceptable to the Commission: (1) a maximum flex rate not to

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[131] T.E., February 22, 1993, at 17.

exceed 150 percent of the fixed transportation rate; (2) a minimum flex rate not less than 50 percent of the fixed transportation rate; and (3) a minimum flex period of 3 months rather than the current 12 months.

The other significant tariff changes proposed by ULH&P dealt with the calculation of minimum bills to reflect the administrative charge under Rate IT, the customer's cost responsibility for metering equipment installed to monitor daily usage, and ULH&P's right to physically discontinue service if a customer refuses to interrupt service at ULH&P's request. No party opposed these changes, they are reasonable, and should be approved.

Interruptible Competitive Transportation

ULH&P proposed a new tariff for interruptible competitive transportation service ("Rate ICT") designed to attract new business into its service area and to encourage expansion of existing customers' loads. Under Rate ICT, new or expanded loads would receive a discount of one-third off the fixed rate available on Rate IT. By ULH&P's own admission, Rate ICT is essentially an economic development rate ("EDR").[132] The Commission advocates the use of special contracts negotiated with individual large commercial and industrial customers to implement EDRs.[133] This limits the number of EDRs and reduces the amount of lost revenues from discounted rates. ULH&P's Rate ICT tariff does neither and therefore shall not be approved.

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132 T.E., Vol. I at 148.

133 Id., at 15.

Weather Normalization Rider

ULH&P proposed a weather normalization adjustment tariff ("Rider WNA") to establish a mechanism to adjust base rates during a heating season to compensate for revenue overcollections or shortfalls caused by colder or warmer than normal temperatures during the prior heating season. ULH&P suggested that Rider WNA would stabilize both its base revenues and customers' gas costs, albeit on a delayed basis.

The AG was opposed, maintaining that Rider WNA constituted a single issue rate adjustment that considers weather in isolation from other factors. The Commission concurs. We are not persuaded that customers need the stabilization of gas costs offered under Rider WNA. The built in delay creates the potential for abnormal weather to exacerbate, not moderate, the present fluctuations in customers' bills. Stabilizing gas costs is better accomplished through the budget billing plan offered by ULH&P pursuant to 807 KAR 5:006, Section 13(2)(a). The primary benefit of Rider WNA would inure to ULH&P by substantially reducing its exposure to the impact of abnormal temperatures on gas sales. Absent a detailed analysis of this risk and given the other problems previously outlined, Rider WNA is not acceptable.

Bad Check Charge

ULH&P proposed to increase its bad check charge for gas customers from $8 to $15. It cited $15 as its approximate cost of processing checks returned for non-sufficient funds, which include internal handling cost per returned check of approximately $5 and bank charges of approximately $9 per check. The AG maintains that publicizing a small increase would be a more effective deterrent than increasing the charge by 87 percent. He further argues that the percentage increase in the charge should not exceed the percentage of overall increase in revenues.

The Commission has previously denied a similar request because ULH&P failed to provide adequate cost support.[134] Here, ULH&P has provided cost support which shows that, depending on the bank involved, it incurs a total cost ranging from $12 to $14 for each returned check.

When a check is rejected and returned to ULH&P's bank, ULH&P is charged a fee of $3 to $3.50. At its instruction, returned checks are then processed a second time by the customer's bank. If sufficient funds have been deposited, the check clears and ULH&P incurs the aforementioned $3 to $3.50 fee, which is not passed on to the customer because the check is not again returned to ULH&P. If a check is rejected a second time, ULH&P is charged an additional fee of $3.50 to $6.50 and the check is returned to ULH&P for internal processing.

It is inequitable for those customers who cause ULH&P to incur the first fee to escape a bad check charge because their checks clear during the second processing, when those customers who cause ULH&P to incur both first and second fees would be charged for both. ULH&P's bad check charge should reflect its internal costs and an average of its banks' second pass processing fees. Applying ULH&P's weighted cost data, the bad check charge applicable to gas customers should be increased from $8 to $11.

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[134] Case No. 91-370, Order dated May 5, 1992, at 71.

Implementation of Late Payment Policy

The AG claimed, and ULH&P did not refute, that ULH&P has not notified its customers of the change in late payment policy ordered by the Commission in Case No. 91-370. That change permits a customer to pay his current month's bill in full and make at least a $5 contribution toward his past due balance without incurring a late payment charge.

The AG asserts that ULH&P's practice of informing individual customers of the policy when they have payment problems is insufficient. The AG contends that customers should be notified of the policy in advance. We concur. ULH&P should notify its customers of this policy through a bill insert.

Propane Study

In Case No. 90-041, the Commission instructed ULH&P to undertake a comprehensive study to determine its optimal propane inventory level. The study was to analyze historic use, peak day use, and capacity requirements, and include econometric modeling.[135] ULH&P annually conducts a comprehensive analysis of its gas supply requirements, including propane storage, which includes modeling of peak day requirements, forecasts of peak loads under differing circumstances, and examination of capacity requirements which consider propane storage inventories.[136]

However, determining the portion of total gas supply requirements supplied by propane does not equate to analyzing the optimal inventory level. ULH&P has been able to reduce the amounts

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135 Case No. 90-041, rehearing Order dated July 19, 1991, at 5.

136 Response to the Commission's Order dated November 13, 1992 Order, Item 1.

of natural gas under contract from its pipeline suppliers by using propane. Determining an optimal inventory level could identify additional potential savings. Therefore, ULH&P shall undertake a comprehensive study to determine its optimal propane inventory level which shall be provided to the Commission no later than the time ULH&P files its next general rate case.

Scott, Madden and Associates Study

As part of its reorganization in late 1992, ULH&P retained Scott, Madden and Associates to assist it in a self-analysis of the ULH&P and CG&E organization and procedures. ULH&P was asked to file the study results in this record but responded that it received no written report.[137] It was then asked to provide a summary of the recommendations and comments but has, to date, failed to do so.

This request is not unreasonable or burdensome. The information requested by the Commission is directly related to its downsizing activities and ULH&P has not explained its failure to provide it. Therefore, ULH&P shall provide the requested summary within 30 days of the date of this Order.

Management Audit Implementation

ULH&P was asked to identify, based on its September 1, 1992 Status Report, the costs, savings, and avoided costs resulting from the implementation of its 1989 management audit. The schedule was to distinguish CG&E and ULH&P and allocate the ULH&P amounts

[137] Response to the Commission's Order dated November 13, 1992, Item 7.

between electric and gas operations. The schedule had not been prepared.[138]

In its final Orders in Cases No. 90-041 and No. 91-370, the Commission has expressed concern over ULH&P's refusal to report the results from implementing the management audit recommendations. It appears that ULH&P has taken a cavalier attitude to the implementation of the management audit recommendations. Therefore, ULH&P shall provide this schedule, in the detail originally requested, within 30 days of the date of this Order.

Refund Requirements

On April 26, 1993, ULH&P placed its proposed rates in effect as permitted by KRS 278.190. On April 29, 1993, ULH&P was ordered to maintain records necessary to enable it, the Commission, or its customers to determine the amount of any possible refunds and to whom they would be due. Given the difference in the increase granted and the amount proposed, refunds will be required. Refunds shall be made for all rates and charges exceeding the rates and charges prescribed in this order. ULH&P shall file the amount of excess revenues collected from April 26, 1993 through the day before the date of this Order with the Commission, along with a refund plan designed pursuant to KRS 278.190(4).

The plan shall include interest for the period the excess revenues were collected at the average of the Three-Month Commercial Paper Rate as reported in the Federal Reserve Bulletin and the Federal Reserve Statistical Release. The refunds shall be based on each customer's usage while the proposed rates were in

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138 Response to the Commission's Order dated November 13, 1992, Item 39 and T.E., Vol. II, April 20, 1993, at 30.

effect and shall be made as a one-time credit to the bills of current customers and by check to customers that have discontinued service since April 26, 1993. ULH&P's report of excess revenues and its proposed refund plan shall be filed within 30 days of the date of this Order.

SUMMARY

After consideration of all matters of record and being otherwise sufficiently advised, the Commission finds that:

1. The rates in Appendix A are the fair, just, and reasonable rates to be charged by ULH&P for service rendered on and after April 26, 1993.

2. The rates proposed by ULH&P would produce revenue in excess of that found reasonable herein and should be denied.

3. The rate of return granted herein is fair, just, and reasonable, and will provide for the financial obligations of ULH&P with a reasonable amount remaining for equity growth.

4. The tariff changes proposed by ULH&P, as modified herein, are reasonable and should be approved.

5. ULH&P should file within 30 days of the date of this Order its report of excess revenues collected under the rates placed in effect April 26, 1993 and its proposed plan for refunding those excess revenues.

IT IS THEREFORE ORDERED that:

1. The rates in Appendix A be and they hereby are approved for service rendered by ULH&P on and after April 26, 1993.

2. The rates proposed by ULH&P be and they hereby are denied.

3. The tariff changes set forth in Appendix A be and they hereby are approved effective for service rendered on and after April 26, 1993.

4. ULH&P shall file its report of excess revenues and its proposed refund plan within 30 days from the date of this Order.

5. Within 30 days from the date of this Order, ULH&P shall file with the Commission revised tariff sheets setting out the rates and tariffs approved herein.

6. Within 30 days from the date of this Order, ULH&P shall file with the Commission a narrative summary of the recommendations and comments offered by Scott, Madden and Associates relating to ULH&P's recently completed self-analysis study.

7. Within 30 days from the date of this Order, ULH&P shall file with the Commission a schedule based on the September 1, 1992 Management Audit Status Report showing identified costs, savings, and avoided costs resulting from the implementation of management audit recommendations. The schedule shall breakdown the requested items between CG&E and ULH&P and will show the allocation of the ULH&P portion between electric and gas operations.

8. By the time ULH&P files its next general gas rate case, it shall have completed a comprehensive study to determine its optimal propane inventory level. This study shall include, but not be limited to, an analysis of historic usage, utilization for peak day needs, capacity requirement studies, and econometric modeling.

Done at Frankfort, Kentucky, this 23rd day of July, 1993.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 92-346 DATED July 23, 1993

The following rates and charges are prescribed for gas customers in the area served by The Union Light, Heat and Power Company. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order. The rates included herein reflect all gas cost adjustments through Case No. 90-041-L.

RATE RS
RESIDENTIAL SERVICE

Customer Charge per Month: $6.27

	Base Rate		Gas Cost Adjustment		Total Rate
Commodity Charge for All CCF Consumed	21.83¢	plus	39.81¢	equals	61.64¢ per CCF

RATE GS
GENERAL SERVICE

Customer Charge per Month: $12.65

	Base Rate		Gas Cost Adjustment		Total Rate
Commodity Charge for All CCF Consumed	19.90¢	plus	39.81¢	equals	59.71¢ per CCF

RATE IT
INTERRUPTIBLE TRANSPORTATION SERVICE

APPLICABILITY

Applicable to curtailable transportation service and available to any customer who: (1) signs a contract with the Company for service under Rate IT; (2) utilizes a minimum of 10,000 CCF per month during the seven consecutive billing periods commencing with customer's first meter reading taken on or after April 1; and (3) has arranged for the delivery of gas into the Company's system, or requests Company to purchase and deliver gas, for customer's sole use at one point of delivery where distribution mains are adjacent to the premise to be served. Any service provided hereunder shall be by displacement and on a "best efforts" basis. The Company reserves the right to decline requests to initiate or continue such service whenever, in the Company's judgment, rendering the service would be detrimental to the operation of the Company's system or its ability to supply gas to customers receiving service under the provisions of Rate RS, Rate GS, Rate FT, and Rate SS.

This tariff schedule shall not preclude the Company from entering into special arrangements with Commission approval, which are designed to meet unique circumstances.

NET MONTHLY BILL

The Net Monthly Bill is determined as follows:
All gas consumed is billed in units of 100 cubic feet (CCF).

Administrative Charge per month: $250.00

Commodity Charge per CCF:

Company will deliver the arranged-for gas, less shrinkage which is equal to the Company's system average unaccounted for percentage, at a rate of $0.074 per CCF except as specified in the "Alternative Fuels" provision;

Plus a take-or-pay recovery charge as set forth on Sheet No. 71 Rider T-O-P, as competitive conditions allow;

Plus, if purchased by Company, an agnecy fee of $0.005 per CCF and a gas cost per CCF based on that supply purchased on customer's bahalf which will not be detrimental to sales service customers.

If the Company is required to install remote meter reading equipment on customer's meter in order to monitor customer usage on a daily basis, customer will be responsible for the cost of such equipment either through a lump sum payment or monthly facilities charge designed to reimburse the Company for the cost of such equipment.

The Company will supplement the customer's gas supply on a best efforts basis for gas delivered through customer's meter in excess of customer's daily and/or monthly transported volumes including prior months' transportation imbalances and Standby Service volumes if applicable. The cost of this supplemental gas supply will not be detrimental to the Company's sales service customers. In the event customer fails to interrupt transportation deliveries at Company's request, or Company is unable to provide supplemental supplies for customer, any excess deliveries through customer's meter will be considered unauthorized deliveries. However, Company shall not be precluded from physically discontinuing service to the customer, if the customer refuses to interrupt service when requested by the Company.

Minimum: The monthly Administrative Charge shown above, and, in addition thereto during the seven consecutive billing periods beginning in April, the 10,000 CCF volume minimum.

If the customer fails to take delivery of 10,000 CCF per month during the months of April through October, customer will be charged, in addition to the Administrative Charge and the charges for the delivered volumes, an amount equal to the difference between 10,000 CCF and the delivered volumes billed at Rate GS.

ALTERNATIVE FUELS

The Company may charge a rate lower than that specified in the "Net Monthly Bill" provision, to meet competition from alternative fuels without prior Commission approval. The decision to charge a lower rate will be made on a case-by-case basis, supported by a statement in the customer's affidavit that absent such lower rate, customer would utilize an alternative fuel source. The lower rate shall not be less than one-half the commodity rate specified in the "Net Monthly Bill" provision.

The Company may also charge a rate higher than that specified in the "Net Monthly Bill" provision if such rate remains competitive with the price of energy from customer's alternative fuel source. The higher rate shall not exceed 150 percent of the commodity rate specified in the "Net Monthly Bill" provision.

Once a customer receives a flexible transportation rate, as described in the preceding paragraphs, the customer must continue to pay a flexible rate as determined by the Company for a period of three months. After three months, the customer may, upon written notification to the Company, apply for a flexible rate for another three months. Absent such notification, customer's rate will convert to the fixed rate established herein.

BAD CHECK CHARGE

CHARGE

The Company may charge and collect a fee of $11.00 to cover the cost of handling an unsecured check, where a customer tenders in payment of an account a check which upon deposit by the Company is returned as unpaid by the bank for any reason.

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 92-346 DATED JULY 23, 1993

The jurisdictional net original cost rate base of ULH&P's combined and gas operations at June 30, 1992 is as follows:

	Company	Gas
Total Utility Plant in Service	$289,180,531	$120,972,384
Add:		
Materials and Supplies -		
Distribution	196,068	0
Gas Enricher Liquids	894,722	894,722
Other	206,131	157,530
Total Materials and Supplies	1,296,921	1,052,252
Gas Stored Underground	1,581,757	1,581,757
Prepayments	439,228	312,291
Cash Working Capital Allowance	4,843,237	2,074,910
Subtotal	8,161,143	5,021,210
Deduct:		
Reserve for Accum. Depreciation	82,639,520	30,727,705
Accumulated Deferred Income Taxes	20,092,197	8,665,363
Investment Tax Credits	225,823	134,107
Customer Advances for Construction	1,783,360	1,783,360
Subtotal	104,740,900	41,310,535
Jurisdictional Net Original Cost Rate Base	$192,600,774	$ 84,683,059

Ratio of Kentucky jurisdictional gas operations to total operations: 43.968 percent.

Notes:

1. Balances for Materials and Supplies and Prepayments were determined using 13-month average balances.

2. Prepayments do not include amounts for the PSC Assessment.

3. Cash working capital allowance was determined by taking 1/8th of actual operation and maintenance expenses less energy charges for the test period.

4. Company amounts are on a jurisdictional basis.

APPENDIX C

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 92-346 DATED JULY 23, 1993

Commission's Adjustment to ULH&P's Overtime Labor Expense based on reported actual overtime hours worked since CG&E announced reduction:

Month	Hours
May, 1992	2,998.6
June	755.4
July	1,793.2
August	831.9
September	989.5
Total	7,368.6
Annualized	17,684.6

Calculated Average Overtime Hourly Wage Rate, TY Actual:
(Schedule C-11.1 of Application)

Total Labor Overtime Dollars	$1,398,872
Total Overtime Hours	54,231.4
Average Overtime Rate per Hour	$25.79

Calculation of Adjustment:

Annualized Overtime Hours	17,684.6
Average Overtime Rate per Hour	$25.79
Annualized Overtime Dollars	$ 456,166
Total Labor Overtime Dollars	$1,398,872
Annualized Overtime Dollars	456,166
Total Overtime Reduction	$ 942,706
Gas Operations Percentage	26.137%
Gas Overtime Reduction	$ 246,395
Percentage Expensed	76.04%
Gas Overtime Expense Reduction	$ 187,359
Less: Overtime In Downsizing	35,230
Total Gas Overtime Expense Reduction	$ 152,129

Gas Operations Percentage based on ratio of Gas O & M to Total O & M expenses, from June 30, 1992 Monthly Report filed with the Commission.
Percentage Expensed is 100% minus 23.96%, TY Capitalization rate from ULH&P's response to the AG's first data request, dated October 21, 1992, Item 144.

APPENDIX D

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 92-346 DATED JULY 23 , 1993

The following schedule shows how the Commission's adjustment for the Downsizing Savings and Amortization of related Costs was determined:

Downsizing Savings - Gas Operations:		
Reduction in Complement, Direct	$ 570,736	
Reduction in Complement, Indirect	721,185	
Reduction in Indirect Overtime	35,230	
Reduction in Travel	8,000	
Total Savings - Gas		$ 1,335,151
Downsizing Costs - Gas Operations:		
CG&E Accrued Costs	$28,404,943	
ULH&P Gas Percentage	4.84%	
ULH&P Portion, Accrued Costs		$ 1,374,799
CG&E Cash Outlays	$ 2,033,294	
ULH&P Gas Percentage	4.84%	
ULH&P Portion, Cash Outlays		$ 98,411
Plus: Consultant Costs		49,619
Total ULH&P Cash Outlays		$ 148,030

Amortization of Downsizing Costs - Gas Operations:	
Accrued Costs -	
ULH&P Portion, Accrued Costs	$ 1,374,799
Amortization over 10-year Period	÷ 10
Annual Amortization of Accrued Costs	$ 137,480
Cash Outlays -	
Total ULH&P Cash Outlays	$ 148,030
Amortization over 3-year Period	÷ 3
Annual Amortization of Cash Outlays	$ 49,343
Annual Amortization - First 3 Years	$ 186,823
Annual Amortization - Remaining 7 Years	$ 137,480

Downsizing Savings outlined in ULH&P's Response to Hearing Request filed May 4, 1993.
Downsizing Costs outlined in ULH&P's Response to the Commission's Order dated February 10, 1993, Item 3.

APPENDIX E

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 92-346 DATED JULY 23 , 1993

The following schedule shows how the Commission's Interest Synchronization adjustment was determined:

	Long-Term Debt	Short-Term Debt
Capital Structure Percentage	46.9%	6.3%
Debt Portion of $79,007,390 Gas Capitalization	$37,054,465	$ 4,977,465
Less Gas CWIP Subject to AFUDC:		
$3,236,000 times 46.9%	1,517,684	
$3,236,000 times 6.3%		203,868
Debt Component less Applicable Portion of Gas CWIP Subject to AFUDC	$35,536,782	$ 4,773,597
Debt Component multiplied by appropriate Annual Cost Rate	9.20%	4.21%
Annualized Gas Interest Expense for each Debt Component	$ 3,269,384	$ 200,968
Total Annualized Gas Interest Expense		$ 3,470,352
Test Year Actual Gas Interest Expense, from Workpaper WPC-3.10a		3,536,270
Decrease in Gas Interest Expense		$ 65,918
Determination of Income Tax Effect -		
Decrease in Gas Interest Expense		$ 65,918
State Income Tax Rate		8.25%
State Income Tax Effect of Decreased Interest Expense		$ 5,438
Decrease in Gas Interest Expense ($65,918 - $5,438)		$ 60,480
Federal Income Tax Rate		34.00%
Federal Income Tax Effect of Decreased Interest Expense		$ 20,563
Total Income Tax Effect		$ 26,001

Total Gas Capitalization is the sum of the jurisdictional gas capital of $76,739,003 and the jurisdictional gas JDIC of $2,268,387.
Gas CWIP Subject to AFUDC from Schedule B-4 of the Application.